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SUBJECT: GLOBAL ECONOMIC CRISIS IN MOLDOVA

¶1. Summary: Moldova's underdeveloped banking sector and stock market and the absence of speculative capital have enabled the country to avoid any initial shock from the global economic crisis. Quite the opposite, the country is set to finish 2008 with seven percent GDP growth and record high levels of foreign direct investment. However, the prospects for 2009 look less promising for Moldova. As the economy is driven largely by remittances from migrant workers and foreign investments, inflows may decline as migrants lose jobs and return home and foreign investment slows. Domestically this could translate into lower consumption and reduce GDP growth. As a result, returning migrant workers with declining employment opportunities abroad might express their dissatisfaction with the ruling Party of Communists (PCRM) and support opposition parties in the upcoming elections. A more serious economic downturn is developing in the more-industrialized separatist region of Transnistria, where industrial production and the level of exports have dropped significantly. End Summary.

THERE IS A FINANCIAL CRISIS WHERE THERE IS A FINANCIAL SECTOR
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¶2. In a news conference held a few weeks ago the National Bank governor Leonid Talmaci said that the banking sector was sound and ready to weather financial turmoil. According to Talmaci the country's financial system has a resilience learned from the financial crisis during the 1998 Russian ruble collapse and an economic crisis with the 2006 Russian wine embargo of Moldovan products. Johan Mathisen, IMF Resident Representative in Moldova, agrees that local commercial banks are well capitalized. They have the highest liquidity levels in Eastern Europe at 31.4 percent although the minimum required is 20 percent. The National Bank has done a good job of raising foreign exchange reserves to unprecedented levels, adequate to keep at bay any immediate pressure on the exchange rate of the national currency, the leu.

¶3. The underdeveloped credit market has enabled

Moldova to avoid a financial crisis. Moldova's banking sector plays a relatively minor role in financing economic activity unlike western economies and the size of the country's stock market is insignificant. The non-resident share of total deposits is low at around 8 percent and does not arouse concerns of capital flight. Mortgage financing is only at its nascent stage. In a remark at a recent news conference Valeriu Lazar, a former Minister of Economy and Trade, noted that there is a financial crisis where there is a financial sector and there is economic crisis where there is an economic sector. Lazar's conclusion was that Moldova has little of either.

¶4. While the financial sector is underdeveloped both it and the economy continue to grow. The GOM expects to finish off the year with seven percent GDP growth, record high FDI inflows of up to USD 650 million, an inflation rate of less than 9 percent, a 20 percent increase in exports and a 30 percent increase in imports. The GOM's outlook for next year's state budget is optimistic assuming six percent GDP growth.

MOLDOVANS STILL WARY OF BANKING SECTOR

¶5. Many Moldovans remember the skyrocketing inflation of the early 1990s that wiped out lifelong savings and the subsequent 1998 Russian financial crisis that caused the national currencyQs devaluation almost overnight. Officials have made numerous statements to reassure everyone that the banking sector is safe. In early November the newspaper Moldavskie Vedomosti published an article stating that President Vladimir Voronin told the National Bank Governor to freeze early withdrawals of deposits from banks and suspend licenses of several banks. The National Bank was quick to deny and dismiss the information as "intentional misleading of public opinion with the aim of destabilization of the situation."

¶6. Rumors and uncertainty on financial markets abroad seem to have alarmed some Moldovans and in October bank deposits decreased 4.6 percent. Today there seems to be general confidence in the banking system. The initial tension in the banking sector has abated, yet the situation can change on unfavorable news about the struggling financial sector of Russia and Ukraine. The GOM offers deposit insurance of up to $450 for an account in a bank. Moldovans having more than $450 in savings are aware of the deposit insurance and have accounts in more than one of the 16 banks in the country since the IMF reports that up to 90 percent of all deposits are covered.

MIGRANT WORKERS, REMITTANCES AND POLITICS

¶7. Moldova's economic growth over the recent years has been spurred by large remittances from the countryQs migrant workers. Estimates of the number of Moldovans working abroad range from 350,000 as reported by the International Organization for Migration to estimates of even 1 or 1.1 million. Moldova ranks second in the World Bank global 2007 rankings on the reliance of economic growth on remittances at 38.5 percent of GDP. Last year remittances were around USD 1.3 billion and by the end of this year are projected to reach USD 1.7-1.8 billion. High consumption fueled by growing remittances has stimulated imports into Moldova. The IMF Representative warned recently that the recession on the world

markets may lead to a drop in exports and lower demand for Moldovan labor abroad. The latter may lead to fewer remittances from Moldovans abroad and thus lower consumption and reduced imports. These developments could lead to a decline in VAT and customs taxes which represent the main sources of income for the state budget.

¶8. Moldovans working in construction in the CIS, primarily in Russia, will likely be the first migrants to return home. Authorities estimate that up to three quarters of the over 120,000 Moldovans in Russia are working in construction, where the sector has ground to a halt. Igor Dodon, Deputy Prime Minister and Minister of Economy and Trade, recognizes this as a concern. He says his Russian counterparts have assured him that many Moldovan workers will continue to be employed in large infrastructure projects such as the Sochi Winter Olympics site. Dodon speculates that some 25,000 migrants may be forced to come back in the first quarter of 2009 but asserts that the Moldovan economy will be able to employ them in domestic infrastructure projects. The GOM reports 310,000 Moldovan migrant workers are employed in the European Union. They work predominantly in the service sector in Italy which will not experience an immediate economic recession. Some migrants may lose their jobs but given the dire economic situation in Moldova many would prefer to stay unemployed in the EU. Returning migrants are a source of concern for the ruling PCRM because they could possibly express dissatisfaction with the government in upcoming elections.

REAL ESTATE SLOWDOWN IN MOLDOVA ACCELERATES

¶9. There are signs that the crisis has taken a toll on the real estate market. The construction boom that fueled higher real estate prices and strong annual growth rates of over 20 percent in recent years is now slowing. Data from official statistics show that construction work was down 8.8 percent in the first nine months of 2008. Local analysts now say the current situation reflects what a local newspaper called "a price stabilization with a tinge of stagnation." The local Russian-language newspaper Ekonomicheskoye Obozrenie conducted a survey of realtors to assess the impact of the global financial crisis on the real estate market. Some realtors indicated that Moldovans are no longer rushing to invest in new apartments. The frenzy of 2005 when it took three weeks to find a buyer for an apartment is over. Nowadays it takes at least five and a half months to find a buyer. Moldovans are waiting and expecting realtors to cut prices or are making other choices with their money. According to one realtor, sellers of commercial and industrial space are ready to cut asking prices by up to a half.

EVIDENCE OF AN ECONOMIC SLOWDOWN

¶10. Deputy Prime Minister Dodon says that exports of food products to CIS may suffer and has called on exporters to be careful with payments on eastward deliveries reminding them of the 1998 Russian ruble crisis. Moldovan media also reported that importers were asking advance payment for deliveries from retailers. Lower imports have also affected the transportation sector. Moldovan state-owned railways and trucking companies complained to reporters that as consumers tighten their belts they have fewer goods to transport.

¶11. There is anecdotal evidence that a few Moldovan private TV stations are finding it difficult to renew advertising contracts for 2009 because many major businesses are not rushing to make budget commitments given the uncertainty on the global markets. Some of these companies representing world brands operate out of neighboring Romania and Ukraine where the effects of the global crisis have had a more immediate and significant impact on the national economies.

¶12. In a meeting with the World Bank Regional Director Martin Raiser to discuss the World Bank Moldova Cooperation Strategy, Prime Minister Zinaida Greceanii mentioned the GOM's precautionary measures for 2009. She said the GOM is closely watching the global financial crisis which has not affected Moldova so far but the country has to undertake precautionary measures to avert a crisis next year. The two major challenges are exports and payment capacities on export markets as well as a possible return of Moldovan citizens working abroad. Greceanii sees the return of Moldovan citizens as beneficial given the stringent need for labor in all sectors of the economy.

THE GOM IS PLANNING

¶13. It took officials some time to come out publicly with statements about the impact of the global crisis on remittance-driven Moldovan economic growth. After the initial reaction of talking up the mood of the public, officials are now half-heartedly admitting to some impending fallout from the international markets. The GOM is looking at measures that will focus on four priority areas but has not presented any specifics on actions it will take to support these areas. First the government would like to ensure sufficient liquidity for the banking sector and avoid volatility in the leu's exchange rate. Secondly, the GOM would like to prepare programs to accommodate migrant workers returning home as a result of downsizing in such sectors as construction and transportation in Russia and the EU. Such programs will offer consultancy and financial assistance to those willing to set up and run their own businesses. Thirdly, the GOM would like to begin large construction projects such as roads, gas pipelines and water supply. In particular, the GOM plans to initiate infrastructure development projects estimated at USD 300-400 million in the first half of 2009 when the impact of the crisis will be felt. The GOM will allot 550 million lei (USD 53 million) from the 2009 state budget and expects 116.5 million euros and USD 73 million from the international donor community. Fourthly, the GOM will focus on helping local manufacturers finance their activities through partial coverage of interest payments to banks or through direct government lending to businesses. The GOM plans to use proceeds from privatizations to finance this program. (Note: The GOM has recently announced the pending sale of state shares in 80 enterprises estimated at 4.1 billion lei (USD 395 million) before the end of the year. Opposition and independent media criticize the timing of the privatizations during a global economic crisis. Deputy Prime Minister Dodon commented that these privatizations may help prevent a drop in foreign direct investment.)

TRANSNISTRIA'S INDUSTRIAL BLESSING TURNS INTO A CURSE

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¶14. Transnistria's industry-based economy has always been a source of pride for the break-away region's authorities. However, this concentration has also made it more susceptible to the economic crisis. Tiraspol has been vocal about the effects of the global crisis on its export-oriented, heavy-industry enterprises. Production in the region has been in continuous decline since September. In November the region's industrial output was down 19 percent. Average monthly exports were cut 40-60 percent. The downturn in export markets triggered production cuts and temporary layoffs in the export-oriented Ribnita Metal Plant and Ribnita Cement Plant. Other industrial manufacturers located in the region have also been suffering. Prices on metal products and cement were halved reducing sales further. With the Ribnita Metal Plant accounting for two-thirds of the region's exports and contributing at least one-third of the Transnistrian budget, the "government" in Tiraspol is grappling with difficulties in payment of pensions which in some instances are as much as two weeks late. The region already estimates a 30 percent drop in budget revenues. Authorities of some towns in the region have come up with proposals for hiring those laid off to clean town parks and streets. Transnistria's parliament, the Supreme Soviet, intends to address the Russian Duma to request material and financial aid for the beleaguered region.

COMMENT

¶15. The ruling PCRM of Moldova is striving to maintain a stable macroeconomic situation in the months before the parliamentary elections in spring 2009. Coming up with the proposed measures

to fight off the recession, the GOM has few financial resources of its own to fund such projects and will have to rely on the international community for assistance. A tough IMF fiscal framework has enabled Moldova to weather the initial financial shock of the crisis safely. The banks have high rates of liquidity and the NBM has supported a stable currency. The IMF continues to emphasize that the GOM will have to do more to improve its investment climate, step up regulatory reform and fight corruption to simplify the operation of businesses and attract investments. There has been no major decline in remittances but the export markets for agricultural goods may suffer since two major markets, Russia and Ukraine, are experiencing far greater economic downturns than Moldova.

CHAUDHRY